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BEFORE THE ARIZONA CORPORATION COMMISSION

IN THE MATTER OF THE
APPLICATION OF ARIZONA WATER
COMPANY, AN ARIZONA
CORPORATION FOR A
DETERMINATION OF THE FAIR
VALUE OF ITS UTILITY PLANT AND
PROPERTY, AND FOR ADJUSTMENTS
TO ITS RATES AND CHARGES FOR
UTILITY SERVICE FURNISHED BY ITS
EASTERN GROUP AND FOR CERTAIN
RELATED APPROVALS.

DOCKET NO. W-01445A-11-0310

Arizona Corporation Commission
DOCKETED

JUL 17 2013

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APPLICATION FOR REHEARING OF DECISION NO. 73938

Pursuant to A.R.S. § 40-253, the Residential Utility Consumer Office ("RUCO") hereby applies for rehearing of Decision No. 73938, docketed on June 27, 2013.

I. BACKGROUND

On August 5, 2011, Arizona Water Company ("AWC" or "Company") filed with the Arizona Corporation Commission ("Commission") an application requesting adjustments to its rates and charges for utility service provided by its Eastern Group water systems. AWC also requested several other authorizations in the application.

On February 20, 2013, the Commission issued Decision No. 73736, granting AWC a rate increase for its Eastern Group systems. In Decision No. 73736, the Commission explicitly granted AWC a higher return on equity ("ROE") to recognize and address the infrastructure replacement needs expressed by the Company. (Decision no. 73736 at 61). In addition, the Commission kept the docket open for the purpose of further consideration of AWC's proposed Distribution System Improvement Charge

1 (“DSIC”). (Decision No. 73736 at 104, 113). The proceedings up to and including the
2 issuance of Decision No. 73736 have been subsequently referred to by the parties, and
3 will be referred to herein, as “Phase 1.” The proceedings following the issuance of
4 Decision No. 73736 have been referred to by the parties, and will be referred to herein, as
5 “Phase 2.”

6 By Procedural Order issued February 21, 2013, as modified by Procedural Order
7 issued February 25, 2013, an additional hearing was scheduled to commence April 8,
8 2013. Several additional parties filed for, and were subsequently granted, intervention.
9 On April 1, 2013, Staff filed a Settlement Agreement signed by a number of parties, but
10 not signed by RUCO. The Settlement Agreement proposed that the Commission
11 authorize a system improvement benefits (“SIB”) mechanism for the “timely recovery of
12 the capital costs (depreciation expense and pre-tax return on investment) associated with”
13 certain of AWC’s distribution system improvement projects. (Settlement Agreement at §
14 2.3). Testimony in support of, and opposition to, the Settlement Agreement was filed by
15 the parties. On April 4, 2013, a Procedural Order was issued, ordering that the evidentiary
16 record created in Phase 1 of this matter would be held open and incorporated into the
17 hearing of Phase 2, and that parties may cite to and reference the existing record
18 (developed in Phase 1) at the Phase 2 hearing and in briefs following the Phase 2 hearing.
19 A hearing on the Settlement Agreement was held on April 8 and 11, 2013. Parties filed
20 Closing Briefs on April 29, 2013.

21 On May 28, 2013, Assistant Chief Administrative Law Judge Nodes issued a
22 Recommended Opinion and Order (“ROO”) regarding the Settlement Agreement. The
23 ROO recommended approval of the Settlement Agreement. Further, in recognition that
24 the SIB mechanism is intended to enable AWS to pursue its infrastructure replacement
25 and improvement needs in a more timely manner, the SIB at least partially achieves the
26 same goal as was contemplated by the Commission in awarding a higher ROE in

1 Decision No. 73736. Therefore, the ROO recommended that the 10.55 percent ROE
2 authorized in Decision No. 73736 be adjusted downward to 10.0 percent, “to reflect that
3 commonality of purpose.” (ROO at 55, lines 14-15).

4 Several of the settling parties filed exceptions to the ROO, objecting, among other
5 things, to the ROO’s recommendation to lowering the ROE. Only one party, however,
6 actually claimed the Commission was legally precluded from adjusting the ROE. AWC’s
7 exceptions asserted that lowering the ROE would constitute an improper amendment to
8 and partial rescission of Decision No. 73736, and that such action would be a violation of
9 A.R.S. § 40-252. (Exceptions of AWC at 2-3).

10 The Commission considered the ROO at its Open Meeting on June 12, 2013. The
11 Commission, after significant discussion, adopted Pierce Proposed Amendment No. 3,
12 which modified the ROO to leave in place the 10.55 percent ROE adopted in Decision
13 No. 73736. On June 27, 2013, the Commission issued Decision No. 73938, incorporating
14 Pierce Proposed Amendment No. 3 and other amendments that had been adopted.

15 **II. FAILURE TO DECREASE AWC’S INFLATED ROE UPON**
16 **ADOPTION OF THE SIB MECHANISM WAS UNLAWFUL AND**
17 **UNREASONABLE**

- 18 a. The Commission is not only free to modify the ROE in Phase 2, but it was
19 required to consider whether modification was necessary at the time it
20 adopted the SIB.

21 Decision No. 73938 repeatedly recognizes that the SIB mechanism is an adjustor
22 mechanism. (See, Decision No. 73938 at pg. 52, lines 2-4 (“[t]he SIB mechanism...is an
23 adjustment mechanism established within a rate case as part of a company’s rate
24 structure”); at pg. 59 at Conclusion of Law No. 4). The Arizona Constitution protects
25 consumers by generally requiring that the Commission only change a utility’s rates in
26 conjunction with making a finding, in the context of a full rate case, of the fair value of

1 the utility's property. Rates generally cannot be changed based solely on the change of
2 one particular cost or element of the ratemaking formula, out of a concern for the dangers
3 of piecemeal ratemaking. *Scates v. Arizona Corp. Comm'n*, 118 Ariz. 531, 534, 578 P.2d
4 612, 615 (App. 1978); *see also* Decision No. 56450 at 8. However, the adjustment of
5 rates pursuant to an adjustor mechanism is permitted, as long as the mechanism is
6 adopted as part of a full rate hearing. *Residential Util. Consumer Office v. Arizona Corp.*
7 *Comm'n*, 199 Ariz. 588, 592-93 ¶ 19, 20 P.3d 1169, 1173-74 (App. 2001) ("*Rio Verde*"),
8 citing *Scates* at 535, 578 P.2d at 616. Further, adoption of a ratemaking device such as
9 an adjustor mechanism is reserved for exceptional circumstances. *Scates* at 537, 578
10 P.2d at 618.

11 Here, the Commission established AWC's rates and charges in Decision No.
12 73736, but left the docket open to further consider the adoption of a DSISC or alternative
13 mechanism. Because the Commission is prohibited from adopting an adjustor
14 mechanism apart from its approval of AWC's fair value rate base, the Commission
15 cannot separate its consideration of the SIB from the consideration of all the factors that
16 flow into the rate setting formula, including the authorized ROE. To consider adoption of
17 the SIB without also considering AWC's ROE would violate the requirement, confirmed
18 by the Court of Appeals in *Scates* and *Rio Verde*, that an adjustor mechanism may only
19 be established during a rate hearing. In short, if AWC's ROE was not "on the table"
20 during the Phase 2 proceeding, the Commission was not permitted to establish the SIB
21 mechanism in Phase 2 of the proceeding.

22 b. Failure to decrease the ROE upon adoption of the SIB is unreasonable, as
23 the increased ROE and the SIB serve the same purpose.

24 Decision No. 73736 plainly indicates that the Commission granted AWC an
25 increased ROE in recognition of the Company's infrastructure replacement needs.
26 Decision No. 73736 at 61, lines 9-17. The SIB mechanism is also intended to further the

1 same goal as was contemplated in awarding AWC a higher ROE. (Tr. at 275 [Olea]).
2 The Commission's adoption of duplicative devices (an increased ROE and the SIB
3 mechanism) to address the same problem (to enable AWC to pursue its replacement and
4 improvement needs in a more timely manner) is unreasonable.

5 III. THE SIB DOES NOT QUALIFY AS AN AJUSTOR MECHANISM

6 Permissible adjustor mechanisms allow rates to adjust for the variation in
7 particular *operating expenses*. *Scates*, at 535, 578 P.2d at 616. Further, adjustor
8 mechanisms are appropriate for expenses that routinely fluctuate widely. (Decision No.
9 56450 at 6 (“[t]he principal justification for a fuel adjustor is volatility in fuel prices”);
10 Decision No. 68487 at 14-15 (costs of pipeline integrity management program recovered
11 through an adjustor due to annual fluctuations in the costs). Here, the costs to be
12 recovered through the SIB mechanism are neither operating expenses, nor are they
13 expected to be volatile. Moreover, the SIB mechanism only permits rates to adjust up,
14 not down. Rather than recovering the costs of infrastructure replacements through an
15 adjustor mechanism, the costs to be recovered through the SIB should be recovered
16 through the standard rate adjustment process of a rate case.

17 Additionally, the implementation of rate mechanisms by which rates are increased
18 without full rate case submissions requires exceptional situations. *Scates*, at 537, 578
19 P.2d at 618. No such exceptional circumstances exist here. In the hearing in Phase 1,
20 Staff testified that AWC was not facing extraordinary circumstances due to its
21 infrastructure replacement needs, even assuming a \$67 million cost estimate. (Phase 1
22 Exh. S-4 at 35; Phase 1 Tr. at 1332-33). Nothing has changed about the Company's
23 expenditures to suddenly create an extraordinary circumstance. Phase 2 Tr. at 301.
24 Rather, the only difference which Staff cited at the Phase 2 hearing as an extraordinary
25 circumstance was that the Commission had directed the parties to further discuss the
26 DSIC. Phase 2 Tr. at 301. Essentially, Staff asserted that the Commission's direction to

1 discuss a DSIC created an “extraordinary circumstance” sufficient to justify the use of a
2 rate adjustment mechanism. The courts have previously rejected such an “*ipse dixit*
3 approach” by the Commission to finding extraordinary circumstances to circumvent the
4 constitutional mandate that rates be established in the context of a full rate case. *See, Rio*
5 *Verde* at 593, ¶ 21, 20 P.3d at 1174.

6 **IV. CONCLUSION**

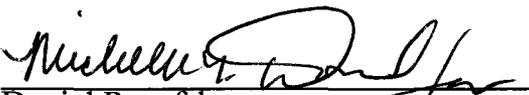
7 The SIB mechanism does not qualify as a true adjustor mechanism. Even if it did,
8 however, the Commission could only implement such a mechanism in a full rate case,
9 which must include an examination of an appropriate ROE. The Commission failed to
10 decrease the ROE it set in Phase I, which ROE was expressly inflated to address the same
11 issue the SIB purports to address – infrastructure replacement and improvement needs.
12 Retaining the 10.55 percent ROE when implementing the SIB results in an unreasonable
13 double-compensation to AWC.

14 DATED this 17th day of July, 2013.

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1 **ORIGINAL** and 13 copies filed
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